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C O N F I D E N T I A L SECTION 01 OF 03 KYIV 000123

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STATE PLEASE PASS TO USTR FOR LMOLNAR/CKLEIN/SDONNELLY
COMMERCE FOR CHRISTINE LUCYK
USDA FOR ALLISON THOMAS, JONANN FLEMINGS

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TAGS: [ETRD](#) [EAGR](#) [ECON](#) [PREL](#) [UP](#)
SUBJECT: UKRAINE: GRAIN EXPORTS BLOCKED; TRADERS SUFFERING

Classified By: Ambassador, Reasons 1.4 (B) and (D)

¶1. (SBU) Summary: Exports of wheat, barley, corn, and rye from Ukraine remain completely blocked as the GOU has not yet implemented the export quota system it authorized on December 8, 2006. Traders estimate that there are over 1.5 million tons of grain in storage at ports, where it is beginning to rot. The GOU is expected to begin issuing export licenses around January 22, but even then, the meager size of the quotas (a total of 1.1 million tons of barley and corn, and only 3000 tons of wheat) will severely limit trade and compound the millions of dollars in losses already suffered by grain traders and by Ukraine's farmers. Speculation on the GOU's motives runs from a desire to create more opportunities for corruption, to an intention to restore a state monopoly over the grain market in Ukraine. Major grain traders met with the AmCham and U.S. and European diplomats on January 16 to discuss coordinating approaches to get the GOU to change its policies. They noted that Ukrainian farmers were difficult to mobilize because they were poorly organized and most had cashed in their crops before the restrictions were in place. Post is aggressively urging key GOU officials to reverse this policy and is looking for new ways to approach the issue, but the Government appears to be dug-in. End Summary.

Rotting Away in the Ports

¶3. (U) At a meeting with U.S., German, and EU diplomats at the American Chamber of Commerce, representatives of Cargill, Bunge Ukraine, and Toepfer (80% owned by Archer Daniels Midland) discussed the grave situation the GOU has created by restricting grain exports. The GOU has not issued any export licenses since November and the grain trade has ceased entirely. Industry representatives estimate that there are 1.6 to 1.7 million tons of grain in temporary storage at Ukraine's major ports (Yuzhniy, Odesa, Mykolayev, Mariupol, and Sevastapol). About half of this grain consists of barley, and wheat accounts for between 200 and 300 thousand tons.

¶4. (U) The grain, in facilities unsuitable for long-term storage, is suffering from rot and insect damage. Temperature of grain stored at Yuzhniy port has exceeded 110 degrees. A surveyor hired jointly by several traders has so far inspected 20 to 30 thousand tons of stored grain at Yuzhniy, and has already separated out over 7000 tons in such poor condition that it can no longer be sold. Since the port storage facilities can be used only to load ships, and not

trucks or trains, returning the grain to suitable grain elevators was not an option. One company, Nibulon, had reportedly already resorted to dumping rotting grain into the water. Bunge had alerted its insurers of the likelihood of filing a claim for losses of \$6-8 million at Yuzhnyi port alone. Insurance companies had jointly sent a representative to the port to keep tabs on the situation. AIG was reportedly in discussions with EU officials on the situation.

Quotas Not Yet Operational...

15. (U) The quota amounts that the Cabinet of Ministers established by decree on December 8 permit export of 3000 tons of wheat, 600,000 tons of barley, and 500,000 tons of corn. Companies seeking a share of this 1.1 million tons of exports submitted applications for licenses totaling 3.9 million tons they were already prepared to export. On December 28, an interagency committee proposed a schedule of allocation of licenses and began to verify that companies actually controlled their claimed quantities of grain. It expects to complete that task by January 19, allowing the Ministry of Economy to begin issuing licenses on January 22.

16. (SBU) In accordance with the CabMin decree, 80% of the quota allocation was apparently based on the historical market share of traders. The proposed allocation of the other 20%, reserved for new entrants, however, caused concern among grain traders. A small Donetsk firm called Reider Trade, for example, received rights to export over 95,000 tons of corn and barley. (Note: Although Reider Trade is believed to be a nominally independent company, its founder has links to Ukraine's leading oligarch Rinat Akhmetov.) The grain traders at the AmCham meeting said they doubted small firms receiving quotas actually controlled the grain, but had falsified warehouse receipts to gain the quotas. Cargill's

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representative told us separately that it had checked on one silo receipt Reider had submitted for 20,000 tons of corn. In fact, according to Cargill, there was no corn in the silo, and the receipt was a forgery.

...And They're Too Small Anyway

17. (SBU) The amount of grain that Ukraine could potentially export before June 30 likely well exceeds even the 3.9 million tons that firms sought to export under this quota allocation. Ukrainian farmers have not yet sold 40% of the crop. Toepfer estimates that Ukraine has an exportable surplus of around 4 million tons of grain beyond that permitted by the quotas.

GOU Motives: Corruption, Statism, or Saving Face?

18. (SBU) Grain traders dismissed out of hand the idea that the export quotas stemmed from a concern for bread prices or a wheat shortage. The fact that Ukraine was placing severe limits on corn and barley was a prima facie refutation of that argument. Another theory was that Ukraine had stumbled into this policy without realizing the consequences, and now needed a face-saving way out. GOU officials have repeatedly cited the experience of the bad harvest of 2003, when Ukraine was caught unprepared and had to import grain. Grain traders said they had proposed face-saving solutions to Deputy Prime Minister Klyuyev repeatedly, and had handed proposals to Prime Minister Yanukovych during his recent U.S. trip. Their proposals would allow the GOU to increase its grain stocks, declare victory, and free up exports, but the GOU had shown no interest in pursuing such a compromise. Cargill noted that Klyuyev had already begun talking about the size of quotas for the 2007-2008 market year.

19. (C) In a January 15 discussion with Ambassador, Economy

Minister Makukha implied that the GUO may find export restrictions, at least for wheat, necessary in the next market year. He noted that 80% of Ukraine's wheat crop was winter wheat, and that the current mild winter was encouraging unseasonably fast growth of the crop. This meant it was highly vulnerable to a late winter frost, which could cause a disastrous 2007 harvest, according to Makukha.

¶10. (SBU) Whether the GOU initiated the quotas out of a sincere concern over shortages, or in order to help politically powerful bakers and millers, they have allegedly created opportunities for corruption. Without citing any specific allegations, the industry reps were convinced that Klyuyev was the chief beneficiary of this corruption.

¶11. (SBU) Another theory gaining currency is that the GOU intends to reintroduce a monopoly on Ukraine's domestic grain market under the state trading company "Khlib Ukrainy" (Bread of Ukraine). Leonid Kozachenko, President of the Ukrainian Agrarian Federation, told Ambassador of this theory in late December and added that the GOU also intended to set up a state-owned commodity exchange run by the Ministry of Agriculture. Cargill's Ukrainian vice president noted that, though Khlib Ukrainy now lacked the funding to take on this role, its representatives were meeting regularly with Yanukovich to find a way to overcome that obstacle.

¶12. (C) Comment: While we believe that some officials may advocate such a plan, we are skeptical that it is a serious option for the GOU. It is likely that the GOU ill-advisedly launched the export restrictions, and that a powerful constituency of venal stakeholders has evolved hoping to perpetuate arbitrary state control over exports. Some traders believe the objective is to force foreign traders out of the market and place the export trade in the hands of local cronies. End Comment.

PR Message: Quotas Hurt Ukraine, Not Just Traders

¶13. (SBU) Cargill, Bunge, and Toepfer agreed to undertake a public relations effort with the goal of creating a political problem for the GOU. There was no sympathy in the population for the big international grain traders. The GOU had convinced Ukrainians that the traders themselves, by exporting "too much" grain early in the market year, had made the quotas necessary. To counter this, it would be necessary to recruit the farmers to take an active role. This would be

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a challenge, since small farmers were unorganized, and most had already cashed in their crops by selling to the traders early. Although the traders estimated that 40% of the crop was still unsold, most of that was in the hands of the 500 to 1000 large agricultural enterprises, who were capable of storing grain until prices recover. If exports do not free up, however, farmers will face serious losses in the next harvest, beginning in June. With the huge carryover from this year, the domestic market will be oversaturated and storage space very scarce. Moreover, if the gap between world and Ukrainian prices remains at the current \$30-\$45 per ton, Ukrainian farmers could lose hundreds of millions.

Diplomatic Approach

¶14. (SBU) Grain traders welcomed our offer to lend a diplomatic hand. They said, however, a reprise of the November press conference that the Ambassador held together with his German and Dutch counterparts could reinforce the impression that this was a foreign, not a Ukrainian problem. One effective approach might be to appeal to national pride by showing "Ukraine's gold" rotting in the portside storage, they suggested. A visit by Ambassador to such a site could attract press coverage. They encouraged high level U.S.-Ukrainian meetings and offered to accompany the

Ambassador if appropriate. (Embassy note: The Ambassador has consistently raised this issue with PM Yanukovich, DPM Kluyev and other key GOU officials, and in spite of their assurances, the issue has not been resolved. End Note.) Companies said they thought the quotas would be a barrier to WTO accession and suggested the USG make that point to the GOU.

EC Cautious

¶15. (SBU) EC Mission Econ Chief Luis Portero took a conservative line at the meeting, saying that there could be no expectation of getting the GOU to eliminate the quotas. The goal therefore should be to ensure that licensing procedures were transparent. To that end, the EU was sending technical experts to Ukraine the week of January 22 to advise the GOU on licensing. He said the Commission had also decided to hold meetings with Ukrainian officials on January 31. European Commission head representative Ian Boag admitted to the Ambassador January 17 that talking to the GOU about improving licensing procedures could easily be construed as accepting the quotas. However, Boag said that the EU would look for next steps after their January 31 meetings. The EC had not discussed whether the quotas constituted a barrier to WTO accession. German agricultural attache, Stefan Kresse, who personally advocates more aggressive action, said he doubted Brussels would make that link explicit.

Comment

¶16. (C) These costly quotas undermine the Yanukovich government's efforts to appear pro-market. In combination with the return to a corrupt system of securing VAT refund payments from the GOU, the quotas confirm the business community's fears about the direction of Ukraine under Yanukovich. Since Post's aggressive private and public diplomacy has not yet produced tangible results, we continue to look for new ways to raise the profile of the issue and are considering a February 1 visit to a grain port facility for the Ambassador.
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